union 76

UNION OIL COMPANY OF CANADA LIMITED ANNUAL REPORT '76

union 76

Highlights

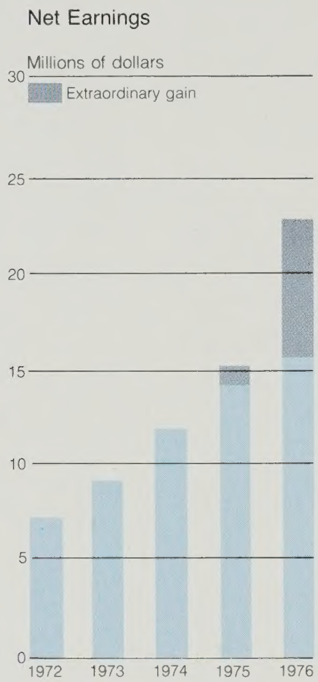
	1976	1975	Increase (Decrease) Percent
Financial			
Total revenues	**$104,595,000**	$ 91,727,000	14.0
Cash flow from operations	**34,704,000**	29,289,000	18.5
per share	**2.41**	2.03	
Cash flow including extraordinary items	**40,721,000**	30,558,000	33.3
per share	**2.83**	2.12	
Earnings before extraordinary items	**15,486,000**	14,363,000	7.8
per share	**1.08**	1.00	
Earnings for the year	**22,713,000**	15,411,000	47.4
per share	**1.58**	1.07	
Dividends	**3,024,000**	8,639,000	(65.0)
per share	**0.21**	0.60	
Capital expenditures during year	**21,824,000**	17,272,000	26.3
Working capital at year end	**21,983,000**	53,712,000	(59.1)
Average shareholders' equity	**$128,735,000**	$152,163,000	(15.4)
Return on shareholders' equity (percent)			
From operations	**12.0**	9.4	27.7
Including extraordinary items	**17.6**	10.1	74.3
Operating			
Gross daily production			
Crude oil and natural gas liquids (bbls)	**27,399**	30,119	(9.0)
Natural gas (mcf)	**68,461**	66,742	2.6
Sulphur (long tons)	**228**	270	(15.6)
Gross proven reserves at year end			
Crude oil and natural gas liquids (bbls)	**126,727,000**	137,031,000	(7.5)
Natural gas (mmcf)	**595,692**	622,833	(4.3)
Sulphur (long tons)	**1,000,000**	1,205,000	(17.0)
Land holdings at year end (net acres)			
Petroleum	**6,494,000**	6,423,000	1.1
Mineral	**308,000**	262,000	17.6

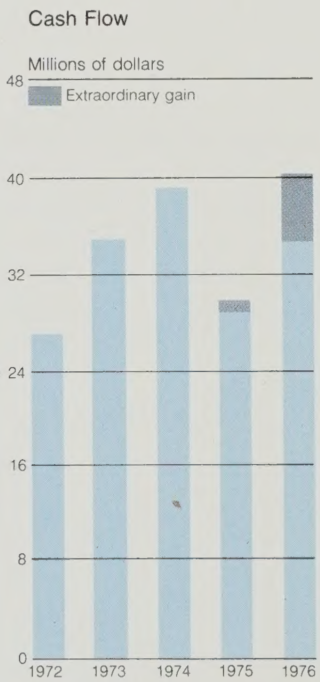
COVER

The cover design portrays a stylized geological cross section, and highlights the Company's intention to concentrate on and expand natural resource exploration and development.

To Our Shareholders

Nineteen seventy-six was a good year for Union Oil. Financial results continued to improve and programs were implemented to expand natural resource exploration and development. Record exploration expenditures and continued improvement in financial results are anticipated in 1977.





We are very pleased to report continued growth in earnings, cash flow and return on shareholders' equity. The bar graphs on this page illustrate the five year trend in earnings and cash flow, including the effect of extraordinary items in 1975 and 1976. Financial and operating highlights are presented on the preceding page and discussed in detail throughout the report.

A capital reorganization was undertaken early in the year with the result that the Company's paid-up capital was reduced by $73.3 million, and this amount ($5.09 per share) was paid to shareholders. The payment was made from funds considered surplus to foreseeable corporate requirements and was not subject to Canadian income tax. In addition, a regular annual dividend of $3.0 million ($0.21 per share) was paid, an amount which conformed to an Anti-Inflation Board ruling.

On April 23 you were informed that an agreement had been reached to sell the Company's refining and marketing assets to Husky Oil, subject to approval of the Foreign Investment Review Agency. This approval was received on October 22 and the assets were transferred to Husky on November 1 for a total consideration of $38.2 million. In reaching the decision to sell these assets the Board of Directors was guided by management's opinion that, to remain in refining and marketing, a substantial capital investment would be required to expand the total system. It was decided that this would not be a prudent investment.

You also were informed in the April letter of our plan to build a stronger and more profitable company by concentrating on and expanding natural resource exploration and development, with emphasis on energy resources — petroleum, coal and uranium. Programs to implement this plan were well underway at year end and will lead to record expenditures in 1977.

Before discussing our 1976 operations and plans for 1977, it is important to comment on federal and provincial government policies which largely determine where, and how aggressively, we invest in exploration.

As a result of the federal-provincial confrontation over sharing of resource revenue, we reduced exploration late in 1974 and through much of 1975. During 1975 Alberta and British Columbia took steps to provide producers with a more equitable share of revenue and we responded during 1976 with a return to full scale exploration in these provinces. The federal government also contributed to renewed activity with taxation adjustments, and more importantly, by supporting a gradual increase in crude oil and natural gas prices.

The federal government has announced a goal of energy self-reliance for Canada. If this goal is to be achieved, industry must also be encouraged to explore more aggressively in the frontier areas. Many policy matters require further adjustment and clarification to provide incentive commensurate with the high risk and cost associated with frontier exploration. Policy matters include revision to the federal government's proposed land regulations and better definition of rights to be granted Petro-Canada. An early decision is required on a pipeline to transport natural gas from the north because exploration investment is also related to expectation of income from frontier discoveries. Federal and provincial jurisdictions must also work co-operatively to remove regional conflicts which are delaying development of other vital energy resources including tar deposits, coal and uranium.

We believe that the goal of self-reliance can be met — given the right economic environment — but time is critical. Governments must move more rapidly and implement policies that will encourage widespread exploration for all potential energy resources.

As a result of higher prices, provincial incentive programs and the opportunity for early cash flow, we have concentrated on and expanded petroleum exploration in Alberta and British Columbia in 1976. A modest effort was directed to federal lands and overseas areas. Exploration of our federal land holdings will be deferred, but we will continue to examine international opportunities in an effort to broaden our petroleum exploration base.

Exploration for coal, uranium and base metals was increased with participation in prospects located in the Yukon Territory, Northwest Territories, British Columbia and Alberta. Evaluation work continued on the Company's 80% owned thermal coal property in Alberta, and results indicate a significant reserve.

The Company's production of crude oil and natural gas liquids decreased in 1976 as a result of decline in older fields and market restrictions caused by reduced crude oil exports to the United States. A new policy for licensing heavy crude oil exports, recently announced by the National Energy Board, should cause a substantial increase in our Saskatchewan production in 1977.

Union's natural gas sales increased slightly as new production more than offset decline in older fields. Sales should continue to increase in 1977, primarily as a result of new production in British Columbia. Natural gas buyers have informed Alberta producers that contracts for new natural gas sales will not be available until at least late 1978. If the surplus becomes a subject of real concern the obvious solution is to create additional markets by increasing exports to the United States under short term contracts.

The outlook for Union Oil in 1977 is encouraging. We anticipate continued improvement in earnings and cash flow. Exploration will expand further as the Board of Directors has approved 1977 spending plans which will result in record outlays. Total spending will be more than covered by cash flow and working capital.

Mr. W. E. Farrar, President of the Company from 1961 to March 1975, did not stand for re-election to the Board of Directors at the last annual meeting of shareholders. His contributions are acknowledged and appreciated. During the year Mr. G. P. Salisbury, Vice President Exploration, resigned to join Union Oil Company of California in Los Angeles. Mr. E. D. B. Laudeman was appointed by the Board of Directors to succeed Mr. Salisbury. Mr. J. C. Browning, formerly Vice President Refining and Marketing, was appointed Vice President Corporate Affairs.

The good results obtained in 1976 are due in large part to the hard work and loyalty of the entire staff. With their continued support we look forward to 1977 with confidence.

On Behalf of the Board

C. W. DUMETT, JR.
President
February 18, 1977

Financial Summary and Analysis

Net earnings in 1976 before extraordinary gain were at a record level and cash flow from operations increased by 18%. Shareholders received capital repayments and a dividend totalling $76.3 million. The assets of the refining and marketing division were sold for $38.2 million. Further improvement in earnings and cash flow from operations is anticipated in 1977.

Earnings and Cash Flow

Union's 1976 net earnings, not including an extraordinary gain, increased 7.8% to a new high of $15.5 million. Net earnings, including the extraordinary gain of $7.2 million, from the sale of Union's refining and marketing assets, totalled $22.7 million. Return on shareholders' equity increased to 12.0% excluding and to 17.6% including the extraordinary gain.

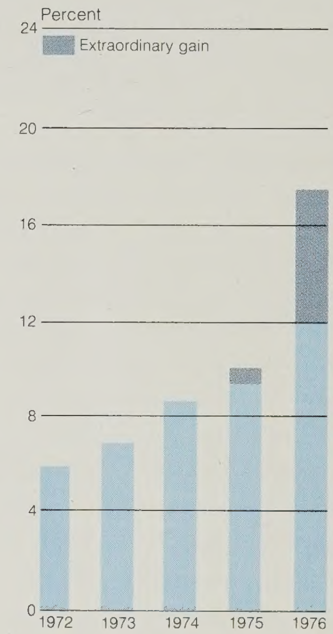
Cash flow from operations was up 18.5% to $34.7 million. Total cash flow, including the extraordinary gain, was $40.7 million.

Revenue

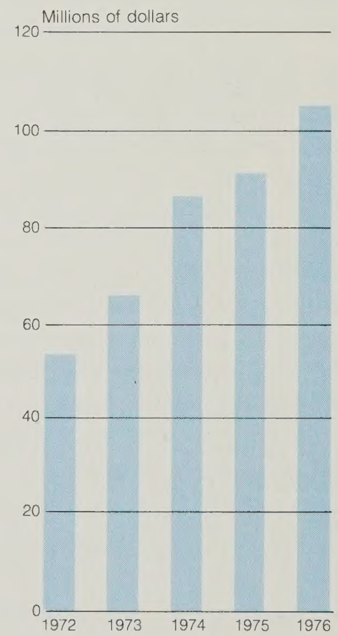
Union's production revenues were up 10.5% to $63.2 million in 1976 and were received from the sale of:

Crude Oil and Natural Gas Liquids	1976	1975	Increase (Decrease) Percent
Alberta	$34,324,000	$34,562,000	(0.7)
British Columbia	4,624,000	4,361,000	6.0
Saskatchewan-Manitoba	10,121,000	7,123,000	42.1
	49,069,000	46,046,000	6.6
Natural Gas			
Alberta	10,840,000	8,575,000	26.4
British Columbia	2,595,000	1,747,000	48.5
Saskatchewan-Manitoba	140,000	100,000	40.0
	13,575,000	10,422,000	30.2
Sulphur			
Alberta	550,000	716,000	(23.2)
TOTAL	$63,194,000	$57,184,000	10.5
Total By Province			
Alberta	$45,714,000	$43,853,000	4.2
British Columbia	7,219,000	6,108,000	18.2
Saskatchewan-Manitoba	10,261,000	7,223,000	42.0
TOTAL	$63,194,000	$57,184,000	10.5

Return on Shareholders' Equity



Revenues from Operations



Increased revenues in 1976 were largely due to price increases rather than from increased production. Net liquid production decreased by 7.8% while net natural gas production increased by 3.1%. Changes in production volumes are discussed in more detail in the Production section of this report. The average selling price per barrel of crude oil and natural gas liquids increased from $6.47 in 1975 to $7.45 in 1976. The average selling price per thousand cubic feet of natural gas increased from $0.54 to $0.68.

In 1975 royalties and production taxes accruing to the Provinces, from Union's production, amounted to $35.3 million or 38% of gross production revenue. In 1976 the amount was $35.5 million or 36% of gross production revenue. The decrease in the Provincial shares of gross revenue, even though modest, indicates some recognition, in Alberta and British Columbia, of the need to leave a greater share of the sales dollar with the producer to encourage energy exploration and development.

Union's refining and marketing division was sold to Husky Oil on November 1, 1976. Revenue from the sale of refined products was $36.9 million for the first ten months of 1976, compared to $29.2 million for the full year of 1975.

Revenue from interest and other income was $4.5 million compared to $5.3 million in 1975. The decrease was caused by a reduction in short term investment income resulting from the payments to shareholders which are discussed later in this section and more fully in notes to the financial statements.

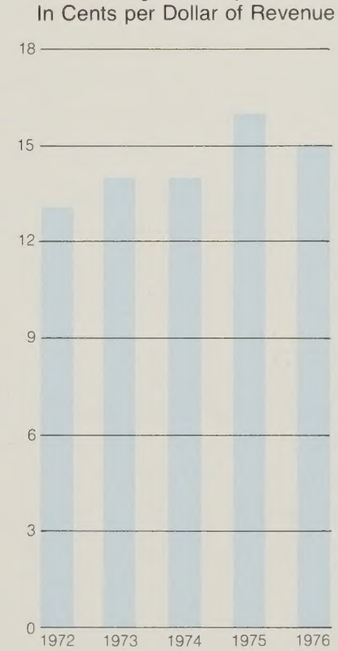
Expenses

Total expenses, not including income taxes, increased by 26.2% in 1976 to $77.5 million. Petroleum production costs were up 26.1% reflecting inflationary cost increases. Exploration expenses, including rentals, were up 50.2% due in part to inflation, but primarily reflecting the Company's expanding exploration program. Refining and marketing expenses, for the ten month period, were up 29.3% over the full year of 1976, due mainly to increased raw material costs.

Provisions for land and dry hole write-offs were up by 43.1% in 1976 to $14.0 million. The increase results in part from the expanded exploratory drilling program but largely from the surrender of lands in the Arctic Islands and Northwest Territories which did not merit further exploration.

Capital Expenditures

Net Earnings from Operations
In Cents per Dollar of Revenue



Income Taxes

Provision for current and deferred income taxes, excluding those related to the sale of the refining and marketing assets, totalled $11.6 million in 1976, compared to $16.0 million for 1975, a decrease of 27.5%. This decrease results from changes in the federal tax legislation which took effect in 1976. The changes provide for increased allowances depending on the level of resource investment in Canada. Union's expanding exploration program has provided and will continue to provide maximum deductions for tax purposes. The Company's effective rate of tax in 1976 was 43% of pre-tax earnings from operations compared to 53% in 1975.

Sale of Refining and Marketing

Effective November 1, 1976 the Company sold its refining and marketing assets to Husky Oil. The sale price was $38.2 million including $5.2 million for inventories. This transaction resulted in a before tax gain of $10.7 million on which income taxes of $4.7 million will be paid currently and an offsetting amount of $1.2 million will be charged against deferred income taxes.

Capital Reorganization

A capital reorganization was approved by the shareholders at the annual meeting in March 1976. The reorganization, which is described more fully in notes to the financial statements, resulted in a return of $73.3 million in surplus funds to shareholders; $40.3 million on June 7, 1976 and $33.0 million on August 16, 1976. The return of capital payments are not subject to Canadian income taxes. The adjusted cost base of the shares was, however, reduced by the amount of the payments received.

Dividend

On July 26, 1976 the Company paid a regular annual dividend in the amount of 21 cents per share. The amount was in accordance with a ruling of the Anti-Inflation Board limiting the payment to 25% of the Company's net earnings in 1974.

Capital Expenditures

Capital Expenditures in 1976 totalled $21.8 million, a 26.3% increase over 1975. These expenditures are listed by category in the five year statistical review. Geographically, 56.0% was spent in Alberta, 33.3% in British Columbia, 2.7% in other areas of Canada and 8.0% in foreign operations.

Summary and Outlook

The financial results for 1976 were encouraging. A new high was achieved in earnings from operations and cash flow from operations was the second highest in the Company's history. Capital expenditures increased and were directed almost entirely to exploration and development. Working capital on hand at the beginning of 1976, the sale of the refining and marketing assets and cash flow provided sufficient funds to make substantial payments to shareholders, maintain a high level of capital expenditures and leave $22.0 million in working capital at year end.

Further improvement in earnings and cash flow from operations is anticipated in 1977. Capital expenditures will increase and will include the largest exploration program in the Company's history. The Company's year end working capital position and cash flow will more than provide for total anticipated expenditures.

Statistical Review

Financial information for the past five years is reported on page 20 of this report.

Exploration and Development

Throughout 1976, programs were implemented to expand natural resource exploration and development. Acquisition of land and seismic data was accelerated with emphasis on prospects in Alberta and British Columbia. A significant coal reserve was confirmed on Company holdings in Alberta. Record exploration expenditures are forecast for 1977.

Petroleum

Petroleum exploration and development in 1976 was concentrated in Alberta and British Columbia. The Company's activities were minimal in Saskatchewan, frontier Canada and overseas. Total exploration and development expenditures were $23.8 million, up 50.2% over 1975. Programs implemented in 1976, both in the office and in the field, have established a base to expand exploration and development in future years.

In 1976 the Company participated in 73 wells; 36 exploratory and 37 development. The exploratory drilling program resulted in 18 natural gas discoveries or extensions. Three of the discoveries may prove significant after further evaluation. The development wells were drilled in 18 field areas in Alberta, British Columbia and Saskatchewan.

A concentrated effort was initiated to accelerate exploration by acquisition of land and seismic data in Alberta and British Columbia. Land expenditures were $6.2 million, compared to $2.0 million in 1975, and resulted in the acquisition of 366,000 net acres (900,500 gross). Seismic data totalling 3,300 miles was obtained through field surveys or purchase.

Alberta

The Company's major exploration and development activity in Alberta was directed to the central and northern areas. Land holdings were increased by the purchase of 71,300 net acres (119,000 gross) and 2,150 miles of seismic data were acquired.

Accelerated geological and geophysical evaluation of total Alberta land holdings has delineated major prospects for drilling in early 1977.

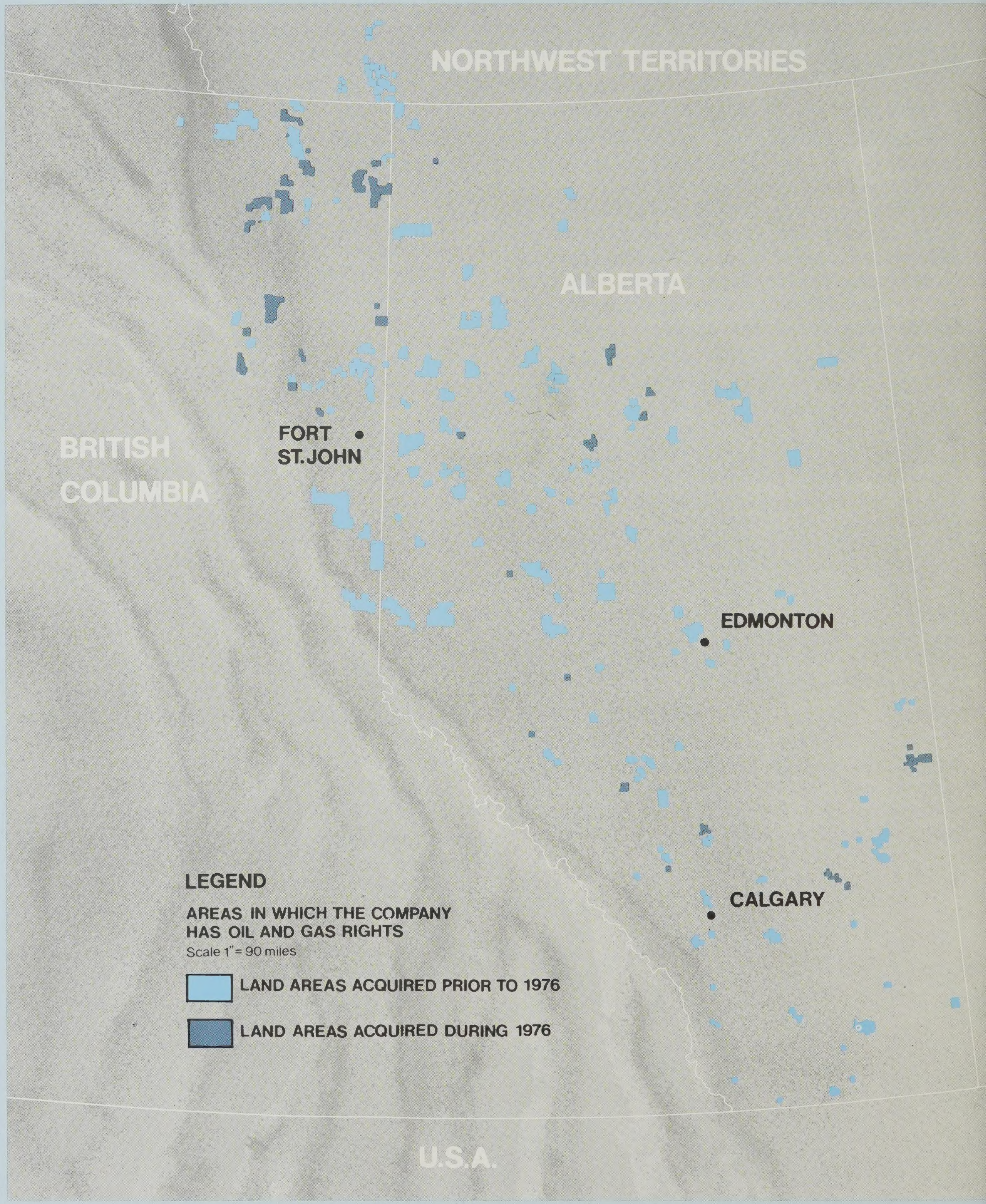
Exploratory drilling was highlighted by three gas discoveries in northern Alberta. These discoveries indicate a potential for significant reserve additions in a region where the Company holds over 300,000 acres of prospective land.

Alberta Drilling

Exploration	1976 Gross	1976 Net	1975 Gross	1975 Net
Gas	16	8.9	1	.3
Dry	14	8.9	12	5.5
TOTAL	30	17.8	13	5.8

Development	1976 Gross	1976 Net	1975 Gross	1975 Net
Oil	6	1.7	3	.7
Gas	17	11.9	18	1.7
Dry	6	3.3	3	.4
Service	1	.3	4	1.8
TOTAL	30	17.2	28	4.6

Alberta is a good place to explore and with improved product prices, exploration incentives and new land regulations, the Company's exploration program will increase. The incentives return a part of our risk investment and the new land regulations will allow more opportunity to acquire Crown lands and initiate earlier action on new exploration concepts.


NORTHWEST TERRITORIES
ALBERTA
BRITISH COLUMBIA
FORT ST.JOHN
EDMONTON
CALGARY
U.S.A.
LEGEND
AREAS IN WHICH THE COMPANY HAS OIL AND GAS RIGHTS
Scale 1" = 90 miles
LAND AREAS ACQUIRED PRIOR TO 1976
LAND AREAS ACQUIRED DURING 1976

British Columbia

The Company's exploration objective in British Columbia during 1976 was to expand the base of operations for increased exploration and production in 1977 and subsequent years. The Company acquired 294,700 net acres (781,500 gross), 1,150 miles of seismic and assigned additional personnel to prospect development.

The 1976 exploratory drilling program was modest but will be increased in 1977. The principal objectives will be Devonian reef natural gas prospects at depths averaging about 9,000 feet.

British Columbia will play a more significant role in our exploration plans for 1977. An improved regulatory and economic climate, increasing product prices, provincial incentives and good exploration prospects for natural gas all combine to indicate a potential for profitable exploration.

British Columbia Drilling

	Exploration			
	1976		1975	
	Gross	Net	Gross	Net
Gas	2	1.3	1	.5
Dry	4	2.5	—	—
TOTAL	6	3.8	1	.5

	Development			
	1976		1975	
	Gross	Net	Gross	Net
Gas	1	.5	2	.2
Dry	1	.1	2	.6
TOTAL	2	.6	4	.8

Saskatchewan

The Company's exploration and development activity was at a low level in Saskatchewan due to non-competitive government policies and a restricted market for heavy crude oil. Drilling activity in 1976 consisted of participation in five development wells. In 1977 a substantial program of development drilling will be initiated if markets for heavy crude oil improve.

Frontier Canada

The Company holds federal lands in the Yukon and offshore in the Beaufort Sea which are highly regarded for reserve potential. Exploration plans will continue to be deferred pending resolution of a transportation system to market production from discoveries, modification to proposed federal land regulations and a better understanding of the preferential rights which may be granted to Petro-Canada.

International

The Company is a 25% participant in a well drilling, at year end, offshore Bangladesh in Southeast Asia. During 1976 exploration opportunities in other countries were examined, and this work will be continued in an effort to broaden the Company's long term exploration program.

Outlook for 1977

In 1977 petroleum exploration and development expenditures are forecast to be at record levels. Approximately 90% of the spending is designated for Alberta and British Columbia, 5% for Saskatchewan and federal lands and 5% for the exploratory well in Bangladesh.

Petroleum Land Holdings at December 31, 1976 (acres)

	Permit/Reservation		Leasehold		Total	
Region:	Gross	Net	Gross	Net	Gross	Net
Alberta	926,421	850,048	1,555,938	948,656	2,482,359	1,798,704
British Columbia	1,010,150	497,751	634,601	314,828	1,644,751	812,579
Manitoba	—	—	1,960	890	1,960	890
Saskatchewan	—	—	166,393	58,162	166,393	58,162
Northwest Territories	3,594,911	2,088,418	339,804	164,031	3,934,715	2,252,449
Yukon	286,452	262,805	2,362	1,573	288,814	264,378
Westcoast Offshore	112,397	112,397	—	—	112,397	112,397
Arctic Islands	566,080	253,741	—	—	566,080	253,741
Beaufort Sea	556,022	278,012	—	—	556,022	278,012
TOTAL CANADA	7,052,433	4,343,172	2,701,058	1,488,140	9,753,491	5,831,312
Bangladesh	2,652,160	663,040	—	—	2,652,160	663,040
TOTAL	9,704,593	5,006,212	2,701,058	1,488,140	12,405,651	6,494,352

Minerals

Exploration for coal, uranium and base metals continued to increase in 1977 with participation in seven prospects located in the Yukon Territory, Northwest Territories, British Columbia and Alberta. Results were encouraging on most prospects and additional evaluation work, including drilling, will be undertaken in 1977.

Further evaluation of the Company's 80% owned thermal coal property in west central Alberta continued during the year. This program of drilling and bulk sampling will be complete in early 1977 and will be followed by a feasibility study. Results to date confirm a significant coal reserve and preliminary marketing discussions have been held with potential customers in eastern Canada and overseas. A substantial coal exploration program, scheduled for central Alberta, was deferred to 1977 as a result of the delay in the issuance of the new Alberta Coal Development Policy.

Outlook for 1977

Expenditures will continue to increase in 1977 to provide for continuing work on prospects developed in prior years and participation in new programs. Exploration will be broadened geographically and will include examination of properties with previously indicated exploration potential. Approximately 50% of the 1977 budget will be directed to coal, 30% to uranium and 20% to base metals.

Mineral Land Holdings at December 31, 1976 (acres)

	Coal Leases/Applications		Mineral Claims		Mineral Permits		Total	
Region:	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Alberta	157,640	144,728	3,360	2,142	48,320	30,804	209,320	177,674
British Columbia	—	—	64,915	31,393	—	—	64,915	31,393
Northwest Territories	—	—	—	—	100,299	90,269	100,299	90,269
Yukon	—	—	21,850	8,350	—	—	21,850	8,350
TOTAL	157,640	144,728	90,125	41,885	148,619	121,073	396,384	307,686

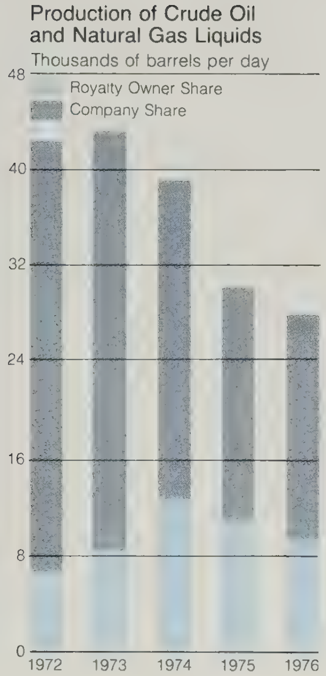
Production

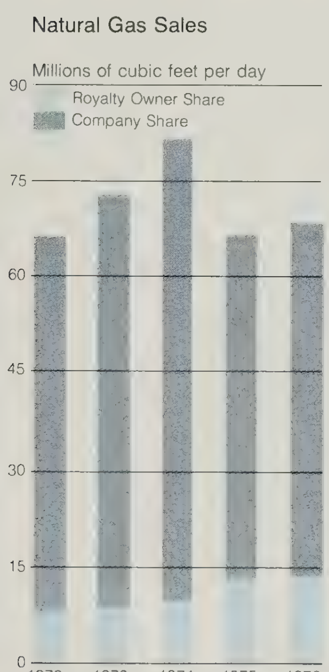
Improved prices and new natural gas sales contributed to a 10.5% increase in production revenue to a record high of $63.2 million. Total barrel equivalent reserves declined by 6.6% to 182.4 million barrels as additions did not offset production and downward revisions to existing reserves. Price increases and new natural gas sales will contribute to further improvement in 1977 production revenue.

Crude Oil and Natural Gas Liquids

Gross crude oil and natural gas liquids production averaged 27,399 barrels per day, a 9.0% reduction from the previous year. Net revenue increased by $3.0 million as price increases more than offset production lost to decline in older fields and market pro-rationing. The average selling price per barrel increased to $7.45 in 1976 from $6.47 in 1975 and will increase further in 1977 as a result of increases received in 1976 and scheduled for January 1, 1977.

The Company's Saskatchewan heavy crude oil production has been severely reduced for two years due to federal tax and export restrictions which made the crude uncompetitive in historical United States markets. In 1976 our production averaged 3,600 gross barrels per day although productive capacity is over 8,000 barrels per day. The National Energy Board has agreed to issue separate export licences for heavy crude, and if allocation arrangements can be made with the United States Federal Energy Administration, we can anticipate a substantial increase in heavy crude production in 1977.





Crude Oil and Natural Gas Liquids Production

	Average Gross Barrels/Day		Average Net Barrels/Day	
	1976	1975	1976	1975
ALBERTA				
Kaybob South	8,381	8,528	5,316	5,581
Red Earth	2,944	3,537	1,909	2,298
Virginia Hills	2,602	3,192	1,503	1,896
Sturgeon Lake South	2,084	2,671	1,236	1,622
Other	2,012	2,012	1,511	1,460
	18,023	19,940	11,475	12,857
BRITISH COLUMBIA				
Milligan	1,310	1,722	620	734
Aitken	1,008	1,137	450	463
Peejay	459	623	241	298
Other	715	815	371	376
	3,492	4,297	1,682	1,871
SASKATCHEWAN				
Cantuar	675	711	576	599
Battrum	565	550	477	462
Steelman	472	520	373	425
Fosterton	400	409	314	321
Other	3,539	3,434	2,904	2,772
	5,651	5,624	4,644	4,579
MANITOBA	233	258	200	221
TOTAL	27,399	30,119	18,001	19,528

Natural Gas Sales

	Average Gross Mcf/Day		Average Net Mcf/Day	
	1976	1975	1976	1975
ALBERTA				
Kaybob South	16,794	20,375	9,836	12,703
Dunvegan	7,343	7,396	4,312	4,480
Crossfield	3,041	3,143	2,585	2,671
Other	11,558	10,948	8,734	8,872
	38,736	41,862	25,467	28,726
BRITISH COLUMBIA				
Clarke Lake	16,372	17,236	16,265	17,137
Silverberry	3,829	2,152	3,829	2,152
Willow	3,107	2,524	3,067	2,431
Spruce	1,002	641	961	613
Other	3,209	687	3,189	687
	27,519	23,240	27,311	23,020
SASKATCHEWAN	2,206	1,640	2,074	1,447
TOTAL	68,461	66,742	54,852	53,193

Natural Gas

Gross natural gas sales averaged 68.5 million cubic feet per day, a 2.6% increase over 1975. Net revenue increased by 30.2% to $13.6 million. The increase in revenue resulted mainly from price increases as new production was sufficient to offset decline in older fields and contribute a modest increase in total production. The average selling price per thousand cubic feet increased to $0.68 from $0.54 in 1975, and will increase further in 1977 as a result of price increases received in 1976 and

scheduled for January 1, 1977. Gross sales are expected to increase in 1977, primarily as a result of new production in British Columbia.

Sulphur

Gross sulphur sales in 1976 were down 2.2% to 215 long tons per day and revenue fell to $550,000 from $716,000 in 1975. Revenues should increase by about 50% in 1977 as new contracts negotiated late in 1976 will increase the average selling price.

Average Selling Price Per Net Unit

	1976	1975	1974	1973
Crude Oil & Natural Gas Liquids ($/bbl)	7.45	6.47	4.94	3.30
Natural Gas ($/mcf)	0.68	0.54	0.26	0.10
Sulphur ($/long ton)	9.72	9.76	8.42	4.68

Reserves

The Company's gross proven developed and undeveloped year end reserves, as calculated by staff reservoir engineers, are summarized in the accompanying table. Total equivalent reserves declined in 1976 as additions did not offset production and downward revisions to existing reserves.

Developed reserves are the quantities that can be recovered through existing facilities. Undeveloped reserves are the volumes estimated to be recoverable from wells to be drilled on proven acreage, from recompletion of existing wells, or from the installation of new facilities. Potential heavy oil reserves at Athabasca and Chipewyan in Alberta are not included. Gross reserves reflect the Company's ownership interest before deducting royalties. Reporting on a gross basis provides more reliable year end reserve data and facilitates year to year comparison of performance. Net reserve calculations are less reliable as a result of the frequent changes in basic royalty rates and supplementary royalties which may vary with price and production rates.

This is the first year that reserves have been reported in total barrel equivalents which permits evaluation of the relative importance of each product.

Operations

Production facility expenditures in 1976 were $2.0 million as compared to $3.5 million in 1975. Emphasis was on connecting new natural gas production and on maintaining or improving efficiency of existing production. Significant investments in Alberta included modifications to tail gas clean-up facilities at the Kaybob South plant and construction of a small gas plant at Youngstown. In British Columbia a testing program was completed and a feasibility study commenced for a combined natural gas storage and production project at Aitken Creek. At year end, preparations were underway to resume a research program of drilling and steam stimulation at the Company's heavy oil holdings at Chipewyan in northern Alberta.

Outlook for 1977

Total production revenue is forecast to increase in 1977 as a result of new natural gas production and improved prices for liquids and natural gas. The increase could be more significant than anticipated if a substantial portion of our shut-in Saskatchewan heavy crude capacity can be returned to production as a result of new export licensing procedures.

Facility expenditures should also increase as we place additional natural gas on production, develop recent natural gas discoveries, and enlarge the heavy oil research program at Chipewyan.

Gross Reserves

	Crude Oil and Natural Gas Liquids (Barrels)		Natural Gas (Thousands of Cubic Feet)		Sulphur (Long Tons)		Total Barrel Equivalents(1)	
	1976	1975	1976	1975	1976	1975	1976	1975
Alberta	87,784,000	94,537,000	361,285,000	349,680,000	1,000,000	1,205,000	122,046,000	128,007,000
British Columbia	4,587,000	6,114,000	200,998,000	245,678,000	—	—	22,926,000	28,530,000
Manitoba	419,000	502,000	—	—	—	—	419,000	502,000
Saskatchewan	33,937,000	35,878,000	26,463,000	20,529,000	—	—	36,352,000	37,751,000
Northwest Territories	—	—	6,946,000	6,946,000	—	—	634,000	634,000
TOTAL	126,727,000	137,031,000	595,692,000	622,833,000	1,000,000	1,205,000	182,377,000	195,424,000

(1) Total barrel equivalents calculated on basis of: 1 barrel of crude oil and natural gas liquids = 10.96 Mcf of natural gas = 0.77 long tons of sulphur.

UNION OIL COMPANY OF CANADA LIMITED
and its wholly owned subsidiary

Year ended December 31

	1976	1975
Revenues		
Sales of crude oil, natural gas, natural gas liquids and sulphur	$63,194,000	$57,184,000
Sales of refined products	36,880,000	29,234,000
Interest and other income	4,521,000	5,309,000
Total revenues	104,595,000	91,727,000
Expenses		
Production	11,799,000	9,356,000
Exploration	3,439,000	2,198,000
Minerals	375,000	23,000
Rentals on unproven lands	1,392,000	1,246,000
Amortization of unproven lands	10,919,000	8,244,000
Depletion	1,114,000	1,160,000
Depreciation	5,211,000	5,938,000
Dry holes and abandonments	3,034,000	1,505,000
Refining and marketing	35,513,000	27,470,000
General and administrative (Note 2)	4,713,000	4,255,000
Total expenses	77,509,000	61,395,000
Earnings from operations before income taxes	27,086,000	30,332,000
Income taxes — current (Note 1)	12,660,000	17,890,000
— deferred (Note 1)	(1,060,000)	(1,921,000)
Earnings from operations before extraordinary gain (per share — 1976 $1.08, 1975 $1.00)	15,486,000	14,363,000
Sale of assets (after income taxes; 1976 current $4,690,000, deferred $(1,210,000); 1975 current $110,000, deferred $221,000) (Note 8)	7,227,000	1,048,000
Net Earnings (per share — 1976 $1.58, 1975 $1.07)	$22,713,000	$15,411,000

Year ended December 31

	1976	1975
Balance at beginning of year	$77,271,000	$68,699,000
Adjustment for overprovision for 1974 income taxes	—	1,800,000
Adjusted balance at beginning of year	77,271,000	70,499,000
Net earnings for the year	22,713,000	15,411,000
	99,984,000	85,910,000
Dividend paid	3,024,000	8,639,000
Balance at end of year	$96,960,000	$77,271,000

See Summary of Accounting Policies and Notes to the Financial Statements.

UNION OIL COMPANY OF CANADA LIMITED
and its wholly owned subsidiary

Consolidated Balance Sheet

December 31

Assets

	1976	1975
Current Assets		
Cash	$ 509,000	$ 752,000
Short term deposits	13,776,000	49,923,000
Accounts receivable	20,561,000	18,667,000
Inventories		
Crude oil and natural gas liquids, sulphur and refined products	218,000	4,848,000
Materials and supplies	3,120,000	3,468,000
Prepaid expenses	1,086,000	947,000
	39,270,000	78,605,000
Property, Plant and Equipment, at cost (Note 4, Note 8)	189,509,000	211,403,000
Less: Accumulated depreciation, depletion and amortization	86,327,000	84,703,000
	103,182,000	126,700,000
Other Assets		
Long term receivables	959,000	1,221,000
Investment in non-controlled companies, at cost	1,012,000	992,000
Operating and performance deposits	879,000	846,000
Deferred charges	—	443,000
	2,850,000	3,502,000
	$145,302,000	$208,807,000

Approved by the Board of Directors

Director

Director

See Summary of Accounting Policies and Notes to the Financial Statements.

Liabilities

	1976	1975
Current Liabilities		
Accounts payable and accrued liabilities	$ 12,237,000	$ 16,693,000
Income taxes payable	5,050,000	8,200,000
	17,287,000	24,893,000
Deferred Income Taxes (Note 1)	26,095,000	28,365,000
	43,382,000	53,258,000

Shareholders' Equity

Share Capital (Note 5)		
Authorized		
22,500,000 shares without par value		
Issued and fully paid		
14,399,190 shares	4,960,000	4,960,000
Contributed Surplus (Note 5)	—	73,318,000
	4,960,000	78,278,000
Retained Earnings	96,960,000	77,271,000
	101,920,000	155,549,000
	$145,302,000	$208,807,000

To the Shareholders of Union Oil Company of Canada Limited

We have examined the consolidated balance sheet of Union Oil Company of Canada Limited and its wholly owned subsidiary as at December 31, 1976, and the consolidated statements of earnings, retained earnings, contributed surplus and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1976 and the results of its operations and the changes in its financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Coopers & Lybrand

Calgary, February 1, 1977

Chartered Accountants

Year ended December 31

	1976	1975
Balance at beginning of year	$73,318,000	$73,318,000
Transferred to paid up capital (Note 5)	73,318,000	—
Balance at end of year	$ —	$73,318,000

Year ended December 31

	1976	1975
Source of Funds		
Total revenues	$104,595,000	$ 91,727,000
Less expenditures involving the outlay of funds	69,891,000	62,438,000
Funds provided from operations	34,704,000	29,289,000
Disposal of property, plant and equipment	326,000	98,000
Disposal of real estate (after current income taxes of $110,000)	—	1,690,000
Disposal of refining and marketing assets (after current income taxes of $4,690,000)	27,370,000	—
	62,400,000	31,077,000
Use of Funds		
Capital expenditures after deducting provincial incentives (Note 6)	18,439,000	16,526,000
Net increase (decrease) in other assets	(652,000)	1,052,000
Dividend paid	3,024,000	8,639,000
Reduction of capital	73,318,000	—
	94,129,000	26,217,000
Increase (decrease) in working capital	(31,729,000)	4,860,000
Working capital at beginning of year	53,712,000	48,852,000
Working capital at end of year	$ 21,983,000	$ 53,712,000
Consisting of:		
Current assets	$ 39,270,000	$ 78,605,000
Less current liabilities	17,287,000	24,893,000
	$ 21,983,000	$ 53,712,000

See Summary of Accounting Policies and Notes to the Financial Statements.

Summary of Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Union Oil Company of Canada Limited and its wholly owned subsidiary Union Oil Holdings Limited.

Inventories

Valuation of inventories is at or below average cost but does not exceed net realizable value.

Leasehold Costs

The cost of acquisition of oil and gas rights, which includes a portion of the costs of wells drilled to earn an interest in such rights and the cost of geophysical surveys which result in acquisition or retention of those rights, are capitalized. Such costs related to unproven oil and gas rights are amortized over the estimated period of retention of those rights and when such rights are surrendered their original cost is charged against the accumulated amortization. When unproven lands become productive the original costs are transferred to proven and, like the acquisition costs of producing properties, are charged against earnings by an annual provision for depletion calculated on a unit of production basis. Total proven reserves, both developed and undeveloped, are used in this calculation.

All oil sands and heavy oil expenditures are capitalized as cost of oil and gas rights and are amortized over the estimated period of retention of those rights.

The cost of acquisition of coal and mineral rights, including a portion of the costs of field exploration work carried out to earn such rights or which result in the acquisition of such rights, are capitalized. Such costs are amortized over the estimated period of retention of those rights.

Exploration and Development Costs

The costs of drilling exploratory wells are charged to expense as incurred, except that a portion of the costs of those wells which are drilled to earn interests in petroleum and natural gas rights are capitalized. The costs of geophysical surveys and the costs of coal and mineral field exploration programs are initially capitalized and such costs which do not result in the acquisition or retention of lands are subsequently charged to expense when the results are evaluated.

Depletion and Depreciation

The costs of drilling successful wells and costs of production equipment and facilities, including gas processing plants, are capitalized and subsequently charged to expense as depletion and depreciation which are calculated on the unit of production basis using in the calculation only proven developed reserves.

Costs of refining, marketing and general facilities are depreciated on the straight line basis over the estimated useful life of the facility.

Income Taxes

The Company follows the practice of claiming maximum capital cost allowance and other deductions in calculating income for tax purposes.

The Company also follows the tax allocation method of accounting for deferred income taxes which makes provision for taxes deferred due to timing differences between expenditures claimed for tax purposes and the charging of those expenditures against earnings in the accounts.

Notes to the Financial Statements

Note 1 — Income Taxes

In calculating taxable income, the companies are permitted to deduct exploration and development expenses and to provide for capital cost allowances at rates which vary from the corresponding write-offs and depreciation recorded in the accounts. Any excess of such costs not used in one year may be carried forward to be deducted in calculating future taxable income. At December 31, 1976, exploration and development expenses totalling approximately $13,900,000 were carried forward. At the same date, approximately $6,900,000 of unclaimed capital cost remained. The comparable figures at December 31, 1975 were approximately $5,400,000 and $20,900,000. The reduction in unclaimed capital cost resulted from the sale of refining and marketing assets which eliminated unclaimed capital cost balances and resulted in capital cost recovery totalling approximately $8,200,000.

In accordance with the income tax allocation basis of accounting, the companies have provided in the accounts for income taxes deferred by reason of all timing differences in claiming costs for tax purposes and charging these costs against earnings for financial accounting purposes. In 1976 and 1975, costs charged against income in the accounts exceeded those claimed for tax purposes resulting in a reduction in deferred taxes of $2,270,000 and $1,700,000 respectively.

The Income Tax Acts provide that certain expenditures may be carried forward for use in calculating depletion to be applied in determining taxable income. At December 31, 1976, the amount of those expenditures which had not been applied, only 33¹/₃% of which may constitute earned depletion, was approximately $24,100,000 ($40,900,000 at December 31, 1975).

Note 2 — Remuneration of Directors and Officers

Statement required by Canada Corporation Act:

(a) number of directors — six
aggregate remuneration as directors — $3,500

(b) number of officers — eight
aggregate remuneration as officers — $380,673

(c) number of officers who are also directors — two

Statement required by certain provincial Securities Acts:

Aggregate direct remuneration paid or payable by the Company and its consolidated subsidiary to the directors and senior officers of the Company amounted to $384,173.

Note 3 — Commitments and Contingencies

In accordance with relevant regulations, the Company had issued non-interest bearing demand notes which are on deposit with the governments of Canada and Alberta to guarantee the performance of exploratory work in respect of certain Crown oil and gas rights granted to the Company. These demand notes totalled $3,247,000 at December 31, 1976.

The Company is contingently liable for the payment of principal (to a maximum of $2,260,000 at December 31, 1976) and interest in respect of certain debentures of a pipeline company of which Union Oil Company of Canada Limited is a shareholder.

Note 4 — Property, Plant and Equipment

	December 31, 1976			
	Gross Investment at cost	Accumulated Depletion, Depreciation and Amortization	Net Investment	Net Investment December 31, 1975
Unproven lands — petroleum	$ 48,672,000	$15,965,000	$ 32,707,000	$ 35,239,000
— mineral	482,000	—	482,000	365,000
Proven lands	40,332,000	24,689,000	15,643,000	15,652,000
Exploration work in progress	1,691,000	—	1,691,000	2,392,000
Oil and gas wells and facilities	76,449,000	34,663,000	41,786,000	39,029,000
Gas plants and facilities	19,153,000	9,669,000	9,484,000	9,974,000
Marketing sites and facilities	—	—	—	15,516,000
Refinery	—	—	—	6,811,000
Other facilities and equipment	2,730,000	1,341,000	1,389,000	1,722,000
TOTAL	$189,509,000	$86,327,000	$103,182,000	$126,700,000

Note 5 — Share Capital

At the Annual Meeting held in March, 1976, the shareholders approved By-Laws 11 and 12 which, subject to confirmation by supplementary letters patent, increased the paid-up capital of the company in the amount of $73,318,324 by transferring that amount from Contributed Surplus and authorized the repayment of an equal amount pro-rata to the shareholders in the amounts of $40,317,732 immediately on receipt of approval, and $33,000,592 at the discretion of the Board of Directors. Supplementary Letters Patent, confirming By-Laws 11 and 12, as required by the Canada Corporations Act were issued on April 2, 1976. The first repayment to shareholders was made on June 7, 1976 in the amount of $2.80 per share and the second and final repayment in the amount of $2.29 per share was made on August 16, 1976. Prior to payment the company had received a ruling from Revenue Canada that these payments to shareholders would not be subject to Canadian Income Taxes and a ruling from the Anti-Inflation Board allowing the payments.

At the meeting of the Board of Directors held on December 6, 1976, options to purchase a total of 120,745 no par value shares of the Company were granted to officers and certain employees. Of the total, options for 24,395 were granted subject to cancellation of old options for the same number of shares. These latter options are exercisable immediately to the extent of 60% of the number issued and the balance within two years and will expire on December 6, 1983. The other 96,350 options are exercisable at the rate of one-fifth of the total held on each anniversary of the date of grant and will expire on December 6, 1986.

As at December 31, 1976, options to purchase no par value shares of the Company were outstanding as follows:

3,100 granted September 17, 1970 at an option price of $10.65 per share, none of which are held by officers or directors,

11,150 granted March 8, 1974 at an option price of $11.95 per share, none of which are held by officers or directors,

120,745 granted December 6, 1976 at an option price of $7.76 per share, of which 91,130 are held by officers, one of whom is a director.

In all cases option prices are 90% of the market price at the date of grant. In the case of the 1970 options, effect has been given to the three for one share split in November, 1972.

Note 6 — Government Incentives

Following enactment in 1974 of federal income tax legislation which assessed income taxes against the resource industries on amounts paid to governments as royalties and other levies, each of the three western provinces initiated incentive programs to encourage exploration and development within their borders. Amounts received during 1976 under the programs totalled $3,590,000. Of that total, $205,000 was credited directly to operating costs, $1,565,000 was initially credited to capital accounts and subsequently written off during the year and $1,820,000 remained credited to capital accounts at the year end. A further amount of $400,000 was applied for under the federal Industrial Research and Development Incentives Act and was credited directly to other income.

Note 7 — Anti-Inflation Act

The Company's results for 1977 will not be directly affected by the anti-inflation guidelines regarding prices and profits because controls over production revenues are governed by different legislation. The amount of dividends which the Company may declare during 1977 will, however, be restricted by the current anti-inflation legislation.

Note 8 — Sale of Assets

On April 23, 1976, the Company entered into an Agreement with Husky Oil Operations Ltd. whereby, subject to approval by the Foreign Investment Review Agency (F.I.R.A.), all of the Company's refining and marketing assets were sold to Husky for the sum of $33,000,000 plus an additional amount for inventory to be determined on closing date based on volumes on hand at that date. That amount was subsequently determined to be $5,200,000. During October approval was received from F.I.R.A. and the effective date of sale was November 1, 1976. Revenues and expenses reported in the financial statements for 1976 for refining and marketing are accordingly for the ten months ended October 31.

The following amounts relative to the refining and marketing operations were included in the accounts on:

	October 31, 1976	December 31, 1975
Accounts receivable	$ 6,738,000	$ 6,730,000
Inventories — crude oil and refined products	4,432,000	4,630,000
— materials and supplies	343,000	389,000
Prepaid expenses	64,000	38,000
Property, plant and equipment — net	21,183,000	22,447,000
Long term receivables	246,000	261,000
Deferred charges	314,000	442,000
Accounts payable and accrued liabilities	(3,738,000)	(3,774,000)
TOTAL	$29,582,000	$31,163,000

All of the above amounts were eliminated at the time of the sale or were collected or paid prior to the end of the year with the exception of $1,100,000 accounts receivable and long term receivables which were still outstanding on December 31, 1976, of which approximately 65% have since been collected. The accounts on December 31, 1976 also included an amount of $5,200,000 due from Husky on the sale of inventories which has since been received.

The excess of sale price over the Company's book value, after deducting depreciation amounted to $10,707,000. Income taxes applicable to the sale of the assets have been calculated to be $3,480,000 ($4,690,000 current, ($1,210,000) deferred).

Note 9 — Comparative Figures

Certain 1975 figures provided for purposes of comparison have been restated to conform to the presentation used in the current year. These changes have no effect on the 1975 earnings.

Five Year Statistical Review

FINANCIAL
(in thousands of dollars, except where otherwise specified)

	1976	1975	1974	1973	1972
Income from all sources	$ 104,595	$ 91,727	$ 85,518	$ 65,259	$ 53,407
Cash expenses (including current income taxes)	69,891	62,438	46,359	30,890	26,914
Cash flow from operations	34,704	29,289	39,159	34,369	26,493
Dollars per share	2.41	2.03	2.72	2.39	1.84
Non-cash expense	20,278	16,847	20,407	21,005	16,503
Provision for deferred income taxes	(1,060)	(1,921)	6,500	4,227	2,826
Earnings for the year	15,486	14,363	12,252	9,137	7,164
Dollars per share	1.08	1.00	0.85	0.63	0.50
Non-recurring profit on sale of assets	7,227	1,048	—	—	—
Dollars per share	0.50	0.07	—	—	—
Working capital	21,983	53,712	48,852	34,499	22,994
Property, plant and equipment, net	103,182	126,700	127,540	122,004	120,174
Investments and other assets	2,850	3,502	2,450	3,547	3,417
Total assets employed	128,015	183,914	178,842	160,050	146,585
Accumulated provision for deferred income taxes	26,095	28,365	30,065	23,565	19,338
Shareholders' equity	101,920	155,549	148,777	136,485	127,247
Dollars per share	$ 7.08	$ 10.80	$ 10.33	$ 9.48	$ 8.85
Return from operations on average shareholders' equity (percent)	12.0	9.4	8.6	6.9	5.8
Number of shares issued and outstanding	14,399,190	14,399,190	14,399,190	14,395,440	14,385,940
Number of shareholders	1,053	992	983	915	858
Dividend paid	$ 3,024	$ 8,639	$ —	$ —	$ —
Dollars per share	0.21	0.60	—	—	—
Market price of shares — high	13.25	9.50	14.00	24.25	20.37
— low	$ 7.12	$ 7.00	$ 6.75	$ 12.50	$ 13.62
Capital expenditures					
Development drilling	$ 3,614	$ 4,863	$ 2,318	$ 4,177	$ 1,515
Oil, gas and gas plant facilities	1,973	3,464	2,861	2,021	2,812
Exploratory drilling	6,842	2,872	9,979	13,722	5,944
Geophysical surveys	2,263	2,700	3,737	1,088	2,616
Mineral exploration	668	620	529	232	—
Acquisition of oil and gas properties	6,242	1,962	5,455	1,110	6,067
Acquisition of mineral properties	63	22	—	—	—
Refining	—	184	385	57	58
Marketing	126	570	1,552	1,048	602
Other	33	15	290	85	521
Total	$ 21,824	$ 17,272	$ 27,106	$ 23,540	$ 20,135

OPERATING

	1976	1975	1974	1973	1972
Average gross daily production					
Crude oil and natural gas liquids (bbls.)	27,399	30,119	39,097	43,042	41,877
Natural gas (mcf)	68,461	66,742	80,809	72,853	65,698
Sulphur (long tons)	228	270	308	308	347
Gross reserves					
Crude oil and natural gas liquids (thousands of bbls.)	126,727	137,031	128,157	147,739	163,833
Natural gas (mmcf)	595.692	622,833	626,586	640,795	633,472
Sulphur (long tons)	1,000,000	1,205,150	978,864	1,191,600	1,338,000
Petroleum land holdings (thousands of net acres)	6,494	6,423	8,430	6,221	5,288
Mineral land holdings (thousands of net acres)	308	262	1,041	995	4
Number of employees	272	337	360	352	371

Directors

C. S. Brinegar
Senior Vice President
Union Oil Company of California
Los Angeles, California

R. A. Burke
Senior Vice President
Union Oil Company of California
Los Angeles, California

C. W. Dumett, Jr.
President
Union Oil Company of Canada Limited
Calgary, Alberta

Fred L. Hartley
Chairman and President
Union Oil Company of California
Los Angeles, California

C. F. Parker
Senior Vice President
Union Oil Company of California
Los Angeles, California

J. M. Tory, Q.C.
Barrister & Solicitor
Tory, Tory, DesLauriers & Binnington
Toronto, Ontario

Officers

Fred L. Hartley
Chairman of the Board

C. W. Dumett, Jr.
President

J. C. Browning
Vice President, Corporate Affairs

E. J. Connor
Vice President, Production

E. D. B. Laudeman
Vice President, Exploration

J. L. Maclagan
Vice President, Finance, Treasurer

R. G. Byers
General Counsel, Secretary

D. B. Jarrett
Comptroller, Assistant Secretary

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Transfer Agent and Registrar
The Royal Trust Company,
Calgary, Montreal, Toronto,
Winnipeg, Vancouver

Subsidiary
Union Oil Holdings Limited

Stock Exchange Listings
The shares of the Company are listed on the Toronto, Montreal, Vancouver and Alberta Stock Exchanges

Auditors
Coopers & Lybrand

Incorporated under the Laws of Canada

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